

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
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Telephone Number:

Refer Reply To:  
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PLR-143015-10  
Date: MARCH 04, 2011

Re:

Legend  
Decedent  
Spouse  
Trust

Trustee  
Date 1  
Date 2  
Date 3  
Date 4  
Date 5  
Date 6  
Year 1  
Year 2  
Year 3  
Year 4  
Year 5  
Year 6  
Year 7  
Year 8  
Year 9  
Year 10  
x  
y  
Court

State  
State Statute

Dear \_\_\_\_\_ :

This letter responds to a letter dated October 15, 2010, from your authorized representative, in which you request rulings concerning the generation-skipping transfer (GST) tax consequences regarding the above-referenced Trust.

### FACTS

Decedent died on Date 1, survived by Spouse who is now deceased. Decedent also was survived by x children, only one of which is still living. Date 1 is prior to September 25, 1985.

Article FOURTH of Decedent's Will provides for the creation of Trust. On the death of Spouse, Article FOURTH provides that trust income is to be distributed to Decedent's issue in equal shares by right of representation. With respect to distributions of principal, Article FOURTH provides:

The trustees shall convey, transfer and deliver, upon written request, to each of my children, discharged of all trust and without compensation therefor, a parcel of land not exceeding [y] acres in area out of my farm located . . . , the location of each parcel to be entirely in the sole discretion of the trustees, they however acceding to the wishes of each child so far as consistent with the best interests of the remaining farm, and in any event said trustees before executing and delivering such a conveyance and transfer shall be satisfied that such child has a genuine intention to erect a suitable residence upon the parcel to be conveyed within two years after such conveyance, and may require such child to furnish a bond with sufficient surety as a guarantee that he or she will erect such a residence within two years after such conveyance or transfer.

Other than some additional distributions of principal for education and professional schools for certain children, Trust does not provide for distributions of principal.

Trust is to terminate at the earlier of the date when no descendant of Decedent is living or the expiration of twenty-one years after the death of the survivor of Decedent's descendants who were living at Decedent's death. Upon termination, principal is to be distributed *per stirpes* to Decedent's then living descendants.

Between Year 1 and Year 2, each child of Decedent requested a parcel of land. Year 1 through Year 2 spans 25 years. Due to disagreements and uncertainties regarding the position or location of the parcels, no parcels have ever been distributed from Trust to any beneficiary. Following the last request in Year 2, litigation ensued over the next 20 years and the following is a general summary. Given the passage of time, some of Decedent's children died and the Trustee was presented with the question of whether the issue of a deceased child had a right to claim their deceased parent's parcel.

In Year 3, Trustee filed a Petition for Instructions with Court. Trustee sought clarification of the persons entitled to request a parcel and the proper procedure to identify parcels for distribution. Some of Decedent's adult descendants were represented by independent counsel and Court appointed guardians *ad litem* to represent minor and unborn descendants and beneficiaries serving in the military. By Year 4, three of Decedent's children were deceased. In Year 5, Court entered an order, the Year 5 Order. The Year 5 Order appears to construe certain Trust terms, approve a settlement among the parties, and approve the sale of certain other real estate held by Trust but not part of the farm. The Year 5 Order was appealed by a beneficiary on the grounds that the beneficiary had not agreed to a settlement or that the settlement was not binding. The appellate court remanded the case noting that oral agreements that settle litigation may be binding, but that the court could not review the matter without evidence in the record on the issue. On remand, Court issued findings of fact that all parties had agreed to a settlement and on Date 2, Court issued a Final Judgment, the Year 6 Order.

The Year 6 Order affirms the Year 5 Order. The Year 6 Order instructs Trustee as to the procedures to select and allocate parcels, permits Trustee to convey the parcels, and provides that the children of each deceased child of Decedent succeeds to the deceased child's option. After attempts over many years to implement the Year 6 Order, Trustee concluded that the parties could not resolve the distribution of parcels under the procedures set forth in the Year 6 Order. Therefore, in Year 7, Trustee filed a petition with Court to modify the prior orders. The petition generally requested that the prior orders be modified to permit beneficiaries the option of receiving a proportionate share of the proceeds from the sale of certain property rather than a specific parcel. Once again beneficiaries attempted negotiations, with some beneficiaries retaining independent counsel while others participated in the discussions without counsel. Court appointed guardians *ad litem* to represent minor and unborn descendants and beneficiaries serving in the military. At this point, over 100 descendants of Decedent were living. The negotiations continued through Year 8.

In Year 9, after consulting with land use professionals, Trustee identified x parcels that could be allocated to Trust beneficiaries. However, certain complications with the local municipality ensued regarding the proposed division and use of the farm. Trustee proposed a possible settlement allowing each family line to request either one of the sited parcels or cash in lieu of a parcel. Some beneficiaries objected to this proposal.

On Date 3, Court held a status conference regarding the implementation of the Year 5 Order as affirmed by the Year 6 Order. On Date 4, Court issued an order, the Year 10 Order. Generally, the Year 10 Order eliminates the beneficiaries' rights to any parcels and substitutes a distribution of cash and a note (carrying interest at the applicable federal rate). The amount to be distributed is determined by using the average per acre value of the farm to determine the amount representing the fair market value of a y-acre parcel. On Date 5, a hearing was held in which several beneficiaries appeared, some of whom made objections to the Year 10 Order. On Date 6, Court issued its Final Order. State Statute provides that a person may appeal an order of the probate court within 30 days of the judgment. More than 30 days has passed since Date 6 and no Trust beneficiary or guardian *ad litem* filed an appeal.

Trust is governed by the laws of State. You represent that no distributions of principal have been made from Trust and that there have been no additions to Trust after September 25, 1985.

You request the following rulings:

1. The Year 5 Order did not result in the loss of GST tax exempt status for any portion of Trust.
2. The Year 10 Order, as entered pursuant to the Final Order, that provides that each Trust beneficiary who has a right to request a parcel will instead receive a distribution in an amount equal to the fair market value of y acres of the farm will not result in the loss of GST tax exempt status for any portion of Trust.

#### LAW AND ANALYSIS

Section 2601 imposes a tax on each generation-skipping transfer. Section 1433(a) of the Tax Reform Act of 1986 (Act) provides that, except as provided in §1433(b), the GST tax applies to generation-skipping transfers made after October 22, 1986.

Section 1433(b)(2)(A) of the Act provides that the GST tax does not apply to transfers under a trust that was irrevocable on September 25, 1985, but only to the

extent that the transfer is not made out of corpus added to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that a trust qualifies for transitional rule relief from the provisions of chapter 13, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii)(A), any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4)(i) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless specifically providing otherwise, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purpose of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to chapter 13, if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Trust was irrevocable on September 25, 1985. It is represented that there have been no actual or constructive additions to Trust after September 25, 1985. Accordingly, Trust is exempt from GST tax under § 26.2601-1(b)(1).

In this case, it is evident from the facts and representations that negotiations and litigation continued over a period exceeding 50 years. The Year 5 Order resolved the issue regarding the identity of beneficiaries entitled to request a parcel after the death of a child of Decedent. However, despite years of negotiations, proposals and judgments from Court, the procedures and conditions regarding the distribution of parcels proved impractical to implement and were never satisfied. The Year 5 Order constitutes a settlement of bona fide issues regarding the administration of Trust and regarding the construction of the terms of Trust. We conclude that the Year 5 Order was the product of arm's length negotiations and represents a compromise that reflects the parties' assessments of the relative strengths of the positions of the various parties, and is within the range of reasonable outcomes under the governing instrument and the applicable state law. Further negotiations and litigation continued for many additional years before resulting in the Final Order that implements the Year 10 Order. The Final Order substitutes the distribution of cash or a note in lieu of a beneficiary's right to a parcel. The amount to be distributed is determined by using the average per acre value of the farm to determine the amount representing the fair market value of a y-acre parcel, and any note carries interest at the applicable federal rate. We conclude that this modification does not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification or extend the time for vesting of any beneficial interest in Trust beyond the period provided in Trust.

Accordingly, based on the facts and representations, we rule as follows:

1. The Year 5 Order did not result in the loss of GST tax exempt status for any portion of Trust.
2. The Year 10 Order, as entered pursuant to the Final Order, that provides that each Trust beneficiary who has a right to request a parcel will instead receive a distribution in an amount equal to the fair market value of y acres of the farm will not result in the loss of GST tax exempt status for any portion of Trust.

The rulings contained in this letter are based upon information submitted and representations made by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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James F. Hogan  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes  
Copy of this letter